

VZCZCXRO0951
OO RUEHLH RUEHPW
DE RUEHIL #0014/01 0051433
ZNR UUUUU ZZH
O 051433Z JAN 10
FM AMEMBASSY ISLAMABAD
TO RUEHC/SECSTATE WASHDC IMMEDIATE 6711
INFO RUEHBUL/AMEMBASSY KABUL PRIORITY 1354
RUEHLO/AMEMBASSY LONDON PRIORITY 2115
RUEHNE/AMEMBASSY NEW DELHI PRIORITY 5942
RUEHKP/AMCONSUL KARACHI PRIORITY 2749
RUEHLH/AMCONSUL LAHORE PRIORITY 8349
RUEHPW/AMCONSUL PESHAWAR PRIORITY 7411
RUEAIIA/CIA WASHINGTON DC PRIORITY
RUEHRC/DEPT OF AGRICULTURE WASHINGTON DC PRIORITY
RUCPDO/DEPT OF COMMERCE WASHINGTON DC PRIORITY
RUEATRS/DEPT OF TREASURY WASHINGTON DC PRIORITY
RHEBAAA/DEPT OF ENERGY WASHINGTON DC PRIORITY
RHMFISS/HQ USCENTCOM MACDILL AFB FL PRIORITY
RUEKJCS/JOINT STAFF WASHINGTON DC PRIORITY
RHEHNSC/NSC WASHINGTON DC PRIORITY
RUEKJCS/SECDEF WASHINGTON DC PRIORITY
RUMICEA/USCENTCOM INTEL CEN MACDILL AFB FL PRIORITY

UNCLAS SECTION 01 OF 03 ISLAMABAD 000014

SENSITIVE
SIPDIS

E.O. 12958: N/A

TAGS: [EFIN](#) [ECON](#) [EAID](#) [ENRG](#) [PK](#)

SUBJECT: CPPA WOULD BRING TRANSPARENCY AND FISCAL AUTONOMY
TO PAKISTAN'S POWER SECTOR PLAYERS

REF: A. 09 ISLAMABAD 2628

[1](#)B. 09 ISLAMABAD 2541

[1](#)1. (SBU) Summary: According to WAPDA Chairman Durrani, PEPCO, the power sector holding company, is morphing into a new WAPDA, taking financial, technical, and human resources control away from Pakistan's public sector distribution and generation companies. PEPCO's metamorphosis is based on the power of the purse, as it controls the flow of payments through the power sector. To overcome this, Durrani has put his support behind the Asian Development Bank's plan to create an independent Central Power Purchasing Authority (CPPA). The CPPA would collect power purchase payments from distribution companies and ensure payments to power producers through transparent accounts. As a conduit for energy sector payments independent from PEPCO, the CPPA would curtail PEPCO's ability to pool distribution company collections, cross-subsidize power sector players, and bury energy sector arrears through financial slight of hand. While there was broad support for the CPPA at the U.S.-Pakistan Energy Dialogue (ref A), Embassy interlocutors agree there will be political resistance to its creation, especially from PEPCO, and resolution of Pakistan's so-called "circular debt" is a necessary precondition to the CPPA's success. Nevertheless, Post concurs with and will actively support the ADB's plan to put the CPPA in place by the GOP's own deadline of April [1](#)2010. End Summary.

The Pros and Cons of PEPCO

[1](#)2. (SBU) In a series of separate meetings with Deputy EconCounselor, GOP interlocutors complained that the Pakistan Electric Power Company (PEPCO) was rapidly becoming the new WAPDA, taking human resources, technical, and, most importantly, financial control from public sector distribution (DISCOS) and generation companies (GENCOS). Water and Power Development Authority (WAPDA) Chairman Shakil Durrani noted that PEPCO was originally created as a power sector holding company with a skeleton staff of 10 employees to oversee the unbundling and eventual privatization of the DISCOS and GENCOS (which had previously been controlled by WAPDA). However, beginning in earnest in 2007, PEPCO began adding staff (it now has over 250 employees), creating new

bureaucratic divisions that have supplanted their WAPDA equivalents, and taking financial control of the distribution companies. Durrani maintains that the power sector will never turn itself around if PEPCO is allowed to complete the construction of its "empire."

13. (SBU) Lahore Electric Supply Company (LESCO) CEO Izhar ul Haq echoed Durrani's concerns. He said his DISCO had financial autonomy until a year ago when PEPCO took full control of revenue collections. He estimated that, if PEPCO had not required all tariff collections to go through its coffers, LESCO would have had \$1.1 billion available for maintaining and improving its operations. However, PEPCO only authorized \$500 million for such activities, and then approved each activity on a line-by-line basis. He said PEPCO uses the power of the purse to control procurements, contracting and human resource management. A bit melodramatically, ul Haq said that "when we try to fly, PEPCO cuts our wings."

14. (SBU) PEPCO Managing Director Taheer Cheema denied that PEPCO was trying to increase its control of the power sector, adding that PEPCO controlled tariff receipts to ensure the overall viability of the sector. He said the DISCOS, including LESCO, maintained financial autonomy, but did admit that PEPCO had a large role to play in "coordinating" the sector. Durrani, however, noted that tariff collections have fallen since PEPCO took control of them, and the DISCOS lack the market incentive to improve. Durrani emphasized that the DISCOS and GENCOS are "autonomous in word, not in deed,"

ISLAMABAD 00000014 002 OF 003

adding that the "most serious problem is that PEPCO won't allow the CPPA to develop."

CPPA: Unbundling PEPCO and restoring market signals

15. (SBU) WAPDA Member Finance Abdul Qadeer explained that the Asian Development Bank (ADB) is also concerned about PEPCO's encroachment and unhelpful role in Pakistan's beleaguered power sector. Under a plan agreed with the ADB, the GOP would create a Central Power Purchasing Authority (CPPA) as an autonomous clearing house for power purchases and single purchaser on behalf of the DISCOS. Each DISCO would place funds in individual escrow accounts with the CPPA; the CPPA would, in turn, pay the GENCOS, independent power producers (IPPs), and WAPDA (for hydropower). Each escrow account would have either a cash float or line of credit (LC) to cover two months of power purchases and allow for payment delays in the billing cycle.

16. (SBU) The CPPA would be incorporated directly under the Ministry of Water and Power. The Secretary of Water and Power would chair the corporate board, which would include a member each from the Ministry of Finance, the DISCOS, the GENCOS and IPPs, and the banks. (Comment: This corporate arrangement leaves the CPPA under GOP control. A preferable option would be to establish it as an independent corporation following the model for NEPRA, the independent power regulator. End comment.)

17. (SBU) Under the CPPA, Qadeer said the DISCOS would have market incentives they currently lack under PEPCO leadership to reduce losses and increase collection, as they would keep all revenue in excess of that needed to purchase power. The DISCOS would also have the financial autonomy to decide how best to allocate these revenues to improve power delivery and further increase collections. GENCOS and IPPs would also gain financial autonomy as they would no longer depend on PEPCO for funds.

18. (SBU) The CPPA would also set the stage for the unbundling of PEPCO. Financial autonomy would remove PEPCO's power of the purse and result in greater DISCO and GENCO control over their operations, human resources, and capital investments.

PEPCO would begin the return to its original function as a temporary holding company for public sector utilities awaiting privatization.

No More Circular Debt?

¶9. (SBU) Qadeer explained that circular debt would no longer be passed through the energy sector. He explained that arrears currently filter through the system, as PEPCO demands that power generators and fuel suppliers provide service without full payment. Under the CPPA, all arrears would stop in the DISCO's escrow accounts: short-term arrears would be covered by the two-month float and the transparency of the escrow payment system would alert the GOP if a DISCO was on the verge of exceeding its float. Unlike the current system, PEPCO would not be able to divert payments from successful DISCOS to failing ones, nor hide losses on the books of its constituent parts.

¶10. (SBU) Qadeer said the energy sector's \$4 billion "circular debt" would need to be removed from the DISCOS and GENCOS books for the CPPA to be successful. The resolution of the debt would need to be combined with tariff increases to ensure that the DISCOS have the financial wherewithal for power purchases, as well as the ability to secure LCs from the banks.

Technical Hurdles for the Creation of the CPPA

ISLAMABAD 00000014 003 OF 003

¶11. (SBU) Qadeer said that four of the nine DISCOS have sufficient collections to cover power purchases. The others would have varying degrees of difficulty covering power purchases, and might require either a GOP or provincial subsidy or a higher tariff until they reduced losses and increased collections. Qadeer said the GOP would also have to guarantee a subsidy for the Tribal Electric Supply Company (TESCO) which provides free power to the FATA, but noted that the GOP had already budgeted support for TESCO in FY09-10.

¶12. (SBU) With the finances straightened, the CPPA could, in theory, be established by April. The GOP would need to take the following technical steps:

- Incorporate the CPPA under the Ministry of Water and Power;
- Name the CPPA Managing Director and appoint the corporate board;
- Amend the National Transmission and Despatch Company (NTDC) license to move the authority for power purchases to the CPPA;
- Create DISCO escrow accounts and provide a two-month power purchase float;
- Provide "seed" money for establishing CPPA operations.

Political Hurdles to the CPPA

¶13. (SBU) WAPDA Chairman Durrani and Finance Member Qadeer clearly back the establishment of the CPPA, seeing it as the first step to break up PEPCO. Qadeer, who is the front runner to head the new CPPA, has an obvious professional interest in its establishment. (Comment: The ADB believes Qadeer would not be an effective CPPA head; we agree, but believe he could be a useful champion for its establishment.) PEPCO Managing Director Cheema would lose his empire if the CPPA were established. But some of his lieutenants are more favorable to it -- most notably, PEPCO CFO Razi Abbas, who, as a former joint secretary at the Ministry of Finance, understands the need to make the sector's finances more

transparent. Finance Minister Shaukat Tarin is also keen to see the energy sector players interact on a commercial basis.

Moreover, at the October 23-24 Energy Dialogue, the GOP delegation headed by Minister of Water and Power Raja Pervez Ashraf expressed their intent to establish the CPPA by April 2010.

¶14. (SBU) Comment: In the coming months, we should focus our energy policy recommendations on three main points: the resolution of the circular debt, the increase in tariffs to cover the full costs of generation and distribution, and the establishment of the CPPA. These three elements are inter-related and incorporated in the World Bank and ADB's plan for reforming the sector, improving its finances, unbundling PEPCO, and ensuring that the sector's constituent parts interact as independent commercial entities. The Pakistani private sector (which depends on power delivery) and the banks (which fear power sector debt will continue to mount) are potential allies in pushing for reform, as are other bilateral donors. End comment.

PATTERSON